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Ensuring Access to Essential Services: Demand-Side Housing Subsidies

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Social Safety Net Primer Series

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Social Safety Net Primer Series

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Abstract

This paper examines the strengths and weaknesses of demand-side subsidy approaches for improving poor households' access to housing services. It begins with a discussion of the rationale for stand-alone housing assistance programs and a description of the ongoing transition away from traditional supply-side housing assistance to demand-side subsidies. The paper presents model demand-side approaches, but also draws on real world examples to highlight various aspects of program design related to targeting, transparency, price distortion, institutional capacity, administrative complexity, and funding. It also describes how variations in the design of housing-related subsidy programs can appear in response to philosophical, political, and resource considerations. The paper concludes with a discussion of the appropriateness of different subsidy approaches for various situations.

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Ensuring Access to Essential Services: Demand-Side Housing Subsidies

Harold M. Katsura and Clare T. Romanik, The Urban Institute[1]

I: Introduction

This paper presents an overview of several demand-side subsidies that governments of developing countries have been using to increase access to housing services among the poor. It is based on a review of existing literature and is intended to be a non-technical guide to help government officials, policymakers, and others to assess their options for assisting the poor. Because any of the approaches presented here might be appropriate depending on the situation in question, this paper does not attempt to define "best practices." Policymakers will have to weigh the strengths and limitations of each approach in deciding which one to use.

The remainder of this paper consists of five sections. The following section presents common reasons for governments to intervene in the provision of housing services. The third section contains a brief overview of trends in the housing sector that have led to the kinds of programs that governments are implementing today. The fourth section describes basic demand-side approaches for subsidizing the housing expenditures of households and discusses their theoretical advantages and disadvantages. This is followed by a fifth section that explores several key implementation topics and discusses how institutional capacity and administrative costs can affect outcomes. The sixth and final section summarizes the pros and cons of these approaches and describes situations for which each might be appropriate.

II: Rationales for Government Intervention

The relative importance of the various rationales for government intervention in the housing sector depends on one's point of view. From the perspective of a social safety net, the main justification for providing housing assistance is that adequate shelter is a basic need that governments have a responsibility to help to fulfill, especially during times of hardship. Although housing assistance programs may already form part of a country's basic economic security system, governments often introduce new programs or expand existing ones as remedial measures following unexpected severe economic shocks or natural disasters. Housing assistance programs can keep families from sliding into poverty after such shocks. In transition countries, instead of simply being a response to a crisis, programs providing the poor with assistance with their housing-related expenditures have been set up in anticipation of them experiencing hardship from planned price increases. In these cases, the introduction of housing assistance makes it possible to implement reforms such as price increases or deregulation.

[1] We would like to thank John Blomquist, Michael Haney, and Chris Jones for their constructive comments.

Housing assistance programs can also satisfy other goals that are important to many policymakers. For example, some programs may promote homeownership and the development of the private sector. Housing and housing-related infrastructure programs can encourage community development or neighborhood revitalization initiatives. Promoting labor mobility has also been increasingly used as a rationale for housing assistance. Housing programs can also support economic development by helping people to set up home-based businesses. At a much broader level, a shift away from supply-oriented subsidies to demand-side subsidies can form part of a strategy to develop a market-based housing sector.

There are several reasons for implementing a stand-alone housing assistance program instead of incorporating it into a general cash benefit program. Ensuring a minimum level of consumption of these goods among the poor is one reason, but other reasons are more pragmatic. Housing expenditures can make up a large portion of the budget of low-income households, and benefit levels are often correspondingly high. Securing political support for expensive programs is easier when benefits are earmarked. The funding source also influences the choice of the subsidy delivery system. When international donors are involved, they may express a preference for stand-alone programs because they may have earmarked funds that cannot be used as general cash assistance.

III: Trends in the Housing Sector

Several trends have emerged in the housing sector that have influenced government policies. Governments everywhere have faced increasing fiscal constraints, and this has motivated them to seek ways to enhance their revenues and cut costs. The relatively high cost of many housing programs makes them obvious candidates for reform. On the revenue side, governments have introduced fees, raised rents and fees, and increased collection rates. On the expenditure side, governments have looked for ways to cut and rationalize subsidies. Often these measures are implemented as a part of a broad package of sector reforms, which might aim, for example, to decentralize responsibility for housing and housing-related services or to privatize state-owned housing. With this pressure to extract a greater contribution from households comes the need to protect the poor from the impact of sector reforms.

In the housing sector in developing countries, there has been a trend away from traditional supply-side assistance to demand-side subsidies. Traditional supply-side housing programs include government-built public housing and other so-called "bricks and mortar" subsidies given to the producers of housing, including, for example, subsidized financing, contributions of land and materials, and tax credits and deductions. With all such programs, producers are obligated to pass on part of the subsidy to households by charging below-market rents for the units that they produce. From the perspective of households, the key characteristic of any supply-side housing program is the lack of choice, in that a household must take or leave what the producer offers. In contrast, demand-side housing programs channel subsidies directly to the household through cash-like allowances or grants. Typically, the household pays the market price and is allowed to select its home from a variety of suppliers. Demand-side subsidies have been used in transition economies to protect households from rent increases during these countries' shift to a market-based system of housing provision. In market economies, demand-side subsidies have been used to increase the transparency and effectiveness of subsidies.

The story of the supply-oriented 1970s and 1980s demonstrates the pitfalls of direct government involvement in the production, financing, and allocation of housing. This experience provided the impetus for the market-driven demand-side approaches that took hold during the 1990s (see World Bank 1993).[2] In the 1970s, the main objectives of governments and donors were to provide affordable land and housing for the poor, attain a high degree of cost recovery, and to replicate the results. Policymakers emphasized "sites and services" projects that were intended to demonstrate the feasibility of providing minimum-standard houses with secure tenure and basic services. Unfortunately, these projects encountered many problems. Too often, targeting was weak so units ended up in the hands of higher-income households, either through the initial allocation of units or the subsequent turnover of units. In some instances, projects failed because people would not occupy undesirable sites that were too far from their jobs and important services. Also, poor households often lacked the additional resources needed to finish their homes, and the limits of the concept of self-help became evident. Cost recovery efforts were often very poor, and this effectively increased the subsidy received by households and made it less likely that the projects could be replicable.

In the 1980s, there was a shift toward implementing projects aimed at providing the poor with financing to buy housing, often through public financial institutions. One of the main goals was to create self-supporting financial agencies that would lend to low- and moderate-income households. Finance was seen as a mechanism that could increase households' own contributions and thereby reduce subsidies. Unfortunately many housing finance projects encountered problems that threatened their long-term viability. Interest rates on loans were often highly subsidized, and in countries with high inflation, the value of repayments in real terms quickly declined, limiting the ability of financial institutions to recover costs. High default rates combined with weak foreclosure laws often made it even more difficult to recover costs. In some instances, the public financial institutions that were running the loan programs hesitated to take harsh actions against households for defaulting on their repayments, which reduced their incentive to pay. Even with heavily subsidized interest rates, the terms of the loans were often not affordable to the truly poor. Frequently the loans were tied to the purchase of newly constructed units built by the government or by private developers to the government's specifications.[3]

By the 1990s, governments concentrated on making the housing sector function better through an integrated approach that focused on both demand and supply issues. On the demand side, policymakers started focusing on clarifying and strengthening property rights, instituting market-rate housing finance, and targeting subsidies to households using demand-side approaches. On the supply side, policymakers began to upgrade existing housing instead of building "sites and services" housing and new housing. Some program sponsors began to incorporate beneficiaries' input into the design and implementation of their projects, thus making them feel like stakeholders. Policymakers also focused heavily on introducing regulatory and institutional reforms that would better serve everyone involved in the housing sector, especially the private sector. Governments increasingly aimed to facilitate the

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[2] This is an invaluable document for gaining a basic understanding of current ideas in housing policy.

[3] A good example of this type of lending is the homeownership credit program (KPR) operated by the state savings bank (Bank Tabungan Negara) in Indonesia in the late 1970s and 1980s. See Struyk, Hoffman, and Katsura (1990) for an evaluation of this program.

development of a vibrant private sector capable of adequately sheltering a large share of the population, thus reducing the need for public housing assistance.

In 1993, the World Bank articulated the views that the global housing policy community had begun to embrace when it recommended: (i) making subsidies transparent; (ii) targeting subsidies on the poor; (iii) switching to demand-side subsidies; and (iv) monitoring subsidies. It discouraged: (i) subsidizing public housing construction; (ii) hidden subsidies; (iii) using subsidies that distort prices; and (iv) rent control.[4]

It has not been easy for many policymakers to break out of the traditional supply-side mentality. However, as experience with these newer principles has grown, policymakers and beneficiaries have gradually accepted them. While most countries today still continue to operate a range of supply-side programs, the newer approaches are often given a high priority by governments and donors when additional funding becomes available.

IV: Program Descriptions

This section focuses on capital grants and allowances targeted to poor households as these are the kinds of demand-side subsidies that are most likely to be recommended and implemented today in the housing sector. Capital grants and allowances typically have many of the characteristics of direct cash transfers. To simplify the following discussion, we focus on a few specific variants of these subsidies. These "models" will help to highlight the key theoretical advantages and disadvantages of the various kinds of subsidies. However, in practice, governments can alter and implement these approaches in ways that can have a profound impact on the actual effectiveness of the subsidies.[5]

In evaluating the relative merits of social assistance programs, it is particularly important to focus on targeting, efficiency, transparency, and administrative simplicity. There are several dimensions to *targeting* including the coverage of the poor and the distribution of the subsidies among those covered. Leakages to higher-income households are also an important targeting issue.[6] A subsidy is *efficient* if it encourages market-compatible behavior, avoids price distortions, minimizes program costs, and discourages the waste created when households do not fully appreciate the value of the subsidies they receive. Demand-side solutions tend to be efficient because they offer a high degree of consumer choice, which helps achieve a high level of satisfaction among beneficiaries at the lowest possible cost. A subsidy is *transparent* when it is possible to clearly identify the beneficiaries as well as the cost of the subsidy. In general, demand-side subsidies that are given directly to households are more transparent than supply-side subsidies in which benefits trickle down through producers to households. Finally, *administrative simplicity* is yet another criterion to consider in evaluating subsidy approaches from an implementation

[4] From table 1 in World Bank (1993).

[5] It is important to understand that variations in the way programs are designed can produce outcomes that are not normally associated with a particular subsidy approach. For example, a program that gives a housing allowance as a direct cash transfer that forces a household to rent a unit from a limited selection of units may produce outcomes that differ little from a traditional supply-side program that discounts rents. In Russia, military personnel relocating from the Baltics were given capital grants to purchase new units but initially were largely forced to purchase units from builders with near monopoly control over new construction. This took away many of the advantages of this demand-side approach.

[6] Exclusion errors occur when needy households fail to receive assistance. Inclusion errors occur when non-poor households are mistakenly given aid. The goal of policymakers is to minimize both types of error.

point of view, as administrative costs can have a major impact on the targeting and effectiveness of a subsidy.

Capital grants and housing allowances are examples of demand-side subsidies, that is, subsidies that are given directly to households or directly paid to service providers on behalf of the households. We now look at each of these subsidies in turn.

Capital Grants

In the housing sector, capital grants are one-time subsidies to households that they can use to purchase, build, or complete (new or existing) units or to rehabilitate existing units.[7] The grants are usually funded via an explicit appropriation process within the government's budget, which makes their cost transparent to the public. The fact that it is not necessary to seek repeated funding to assist a given pool of beneficiaries makes this kind of subsidy attractive to some politicians. On the other hand, capital grants often involve sizeable amounts of money per beneficiary, which can make it difficult for politicians to appropriate funding. To protect against fraud and waste, households may be given their grants in tranches according to what progress has been made or how much work has been completed. The amounts involved can range from the modest (for example, the cost of connecting a house to a utility) to the price of an entire dwelling (although typically not the entire cost).

It is clear from table 1 that capital grants have been popular in South America but are less common in other countries. Latin American countries have tended to implement variations on the so-called "Chilean model." This emphasizes government policies that: (i) shift the responsibility for housing production away from the government to the private sector; (ii) provide one-time grants for home purchase while curtailing all indirect subsidies; and (iii) institute transparent mechanisms for selecting beneficiaries based on household income and a savings contribution. The Latin American experience contrasts sharply with that of Europe and the United States, where demand-side programs have largely taken the form of allowances given to renters. Outside Latin America, the capital grant approach has occasionally been adopted not as an ongoing program but as a response to a particular problem. For example, in Russia, capital grants were used to re-house military personnel returning from the Baltic states, and in Armenia, they are currently being used to help earthquake victims to buy existing apartments. In South Africa, political pressure to improve the housing situation rapidly probably prompted the government to adopt the capital grants approach.

Housing Allowances

A housing allowance is a regular ongoing subsidy to households that offsets some of the costs of their housing and housing-related services. Allowances can be provided to either owners or renters, and they may be used for new or existing housing. Allowances can take two forms. Under one approach, the household receives a fixed subsidy based on norms of the typical prices prevailing in the housing market and must pay the difference between this amount and the total rent (or total housing-related expenditures) of its housing unit. As a result, each household's contribution will vary depending upon how successful it is in finding an economical unit. If the household finds an acceptable unit that costs less than the subsidy

[7] They are also used in conjunction with housing finance programs to "buy down" the prices of units. The idea is to eliminate interest rate subsidies by lowering prices to the point where a household can afford a market rate loan for the difference.

amount, it may keep the remaining amount of the allowance. This approach gives households a powerful incentive to shop for the best housing deal.

Table 1: Direct Demand-Side Subsidies by Country: 1996

Country	*Subsidy type*	*Tenure*	*Dates*[a]	*Funding*
Ongoing programs				
Latin America				
Chile	Capital grant	Owner	1978-present	National
Costa Rica	Capital grant	Owner	1986-present	National
Colombia	Capital grant	Owner	1991-present	National
Uruguay	Capital grant	Owner	1991-present	National
El Salvador	Capital grant	Owner	1991-present	National
Chile	Capital grant	Owner	1978-present	National
Paraguay	Capital grant	Owner	1991-present	National
Western Europe				
Germany	Allowance	Owner/renter	1955-present	National/local
Sweden	Allowance	Renter	1930-present	National/local
United Kingdom	Allowance	Renter	1970-present	Local
Netherlands	Allowance	Renter	1970-present	National/local
France	Allowance	Renter	1948-present	National/local
Austria	Allowance	Renter	1960-present	National/local
Switzerland	Allowance	Renter	1950-present	Local
Norway	Allowance	Owner/renter	1960-present	National/local
Finland	Allowance	Owner/renter	1941-present	National
Denmark	Allowance	Renter	1955-present	National
Eastern Europe				
Poland	Allowance	Renter	1995-present	National
Czech Republic	Allowance	Owner/renter	1993-present	National
Slovakia	Allowance	Owner/renter	1997	National
Estonia	Allowance	Renter	1994-present	National
Latvia	Allowance	Renter	1994-1995	National/local
Lithuania	Allowance	Renter	1994-present	National
Ukraine	Allowance	Owner/renter	1995-present	National
Russian cities	Allowance	Renter	1994-present	Local
Other				
Australia	Allowance	Renter	1945-present	National
Canadian provinces	Allowance	Renter	1970-present	Local
South Africa	Capital grant	Owner	1996-present	National
United States	Allowance	Renter	1979-present	National
Limited-Time Programs				
Panama	Capital grant	Owner	1990	National
Mexico	Capital grant	Owner	1985	National/World Bank
Russia	Capital grant	Owner	1994-present	United States/Russian national government

a. This table was prepared in mid-1996 and represents the situation at that time

Source: Adapted from Conway and Mikelsons (1996), based on data contained elsewhere, including Howenstine (1986), Mikelsons (1996), World Bank (1985), and other sources.

Under the second approach, the government specifies a fixed amount of money that a household must pay towards its own housing costs (usually a percentage of its income) regardless of the total amount of its rent. The government pays the difference between what it deems that the household is able to pay and the rent (or total housing-related expenditures). Under this system, the size of the subsidy varies depending on the household's contribution. There is little incentive for a household to shop for a good deal because it pays the same amount under any scenario. In fact, a household has an incentive to find the most expensive eligible unit that it can find, making this a less cost-effective approach than the first. The attractiveness of this approach is that a household can be sure that it will have to pay no more than a fixed percentage of its income on its housing-related expenses. This approach is sometimes called a burden limit.

Some housing allowance programs have features of both the norm-based and burden limit approaches. For example, the Russian housing allowance program sets a limit for acceptable housing expenses based on social norms and family size. An eligible family living in a unit that has more space than necessary according to the social norm for the family size will either have to relocate or pay the difference between the subsidy based on the norm and their total housing-related expenditures. However, the Russian program does not reward families that find an acceptable unit for less money than it is entitled to according to the social norm. Thus, the Russian program has the "stick" of the first approach but not the "carrot." It is like the second approach in that under no circumstances does it hand out cash to program beneficiaries.

The size of subsidies under a housing allowance program is determined by "the gap formula." According to this formula, the subsidy amount is equal to the "payment standard" minus the household contribution (see box 1). The payment standard is usually tied to market prices and social norms. It can vary according to households' characteristics (for example, size) and geography and is often based on the gross rent concept, which includes rent and utilities. The household contribution is defined as a proportion of the household's income. Usually, the formula uses a measure based on adjusted income that takes into account the household's characteristics, tax liabilities, and assets. The gap formula makes it easy to see how, once income is defined, subsidy costs are sensitive to two variables that are within the control of policymakers—the payment standard and the percentage of income that a household must devote to its housing-related expenditures.

Several points are worth noting about this formula. First, the same method applies whether the subsidy is used to assist households with their rental payments or their home purchase payments. Second, this methodology is equally applicable to the calculation of one-time capital grants. The principle is the same: a one-time subsidy equals a payment standard minus the household contribution. However, in this case, the payment standard may be the average price of a new dwelling or the cost of an upgrade, and the household contribution may be expressed as a factor of annual household income. Finally, accurate income data may not be available for the income variable in the formula. In this case, the household contribution may have to be determined using proxy measures or simply be decided by program administrators.

Box 1: The Gap Formula

Subsidy Amount = Payment Standard - Household Contribution

$$S = P - cY$$

where:

S = periodic subsidy payment

P = payment standard

The payment standard is typically based on:

- social norms/market prices
- household size or other characteristics/geographic price variation
- gross rent (rent plus utilities) or any component of gross rent (for example, utilities only)

cY = household contribution

The household contribution has two components:

- percentage of income devoted to housing-related expenditures (c)
- household income (Y) which may be defined and adjusted in many ways

Source: Authors

A housing allowance, in spite of its name, represents one way to subsidize a variety of housing-related expenditures such as utilities and maintenance fees. In fact, many housing allowance programs are based on the concept of "gross housing expenditures," which, in addition to a rent component, usually includes fees for energy, water, sewage, and solid waste disposal. Conceptually, it is useful to think of housing as something that produces a "flow of services," which includes the services provided by utilities. In transition countries that have transferred ownership of large public housing stocks to sitting tenants, housing allowances often help households to pay for maintenance services and utilities rather than rent.

Table 2 outlines the major parameters of three capital grant programs and one housing allowance program. Two of the capital grant programs (in Armenia and Panama) assisted disaster victims, and the third helped Russian military personnel to resettle in Russia after serving in the Baltic countries, while the housing allowance program was also in Russia. The number of beneficiaries in these three programs ranged from about 2,300 households (in Panama) to 5,000 households (in Russia). The maximum value of the subsidies provided varied tremendously (from just $3,000 in Armenia to $25,000 in Russia), which is a reflection of different market conditions and supply constraints. An incentive was included in the Armenian and Russian capital grant programs, as beneficiaries were allowed to retain the remaining amount of the subsidy that exceeded the price of their accommodation. The Panama example is interesting because participants in the program were allowed to combine their capital grant with other, less transparent subsidies. The Russian housing allowance program reminds us that it is possible to take more than one approach in any given country. This program does not provide very large monthly payments but does reach a larger number of poor households than Russia's resettlement grant program does.

Table 2: Program Examples

	Armenia Earthquake Zone	*Russia Officer Resettlement*	*Panama Plan Chorrillo*	*Russia Housing Allowances*
Purpose of program	Provide housing for uncompensated victims of 1988 earthquake	Provide housing in Russia for military officers resettled from bases in the Baltic countries	Rehouse families from Chorrillo neighborhood of Panama City destroyed by fire in 1990	Provide means-tested assistance for monthly housing and utility fees
Number of beneficiaries	300 (Pilot project) 3,000 (Extended program beginning in 2001)	5,000 (US-funded program)	2,300	Nationwide approximately 6% of the population, according to survey data
Period	1998 to present	1993 to present	1991 - 1993	1995 to present
Subsidy				
Maximum amount	$ 3,000	$25,000	$6,750	Approximately $10 monthly (in 1996)
Amount paid out	Subsidy (even in excess of sales price)	Subsidy (even in excess of sales price)	Lower of subsidy or sales price	[allowance is difference between the maximum social rent and the share of household income expected to be paid for rent]
Other resources				
Supply-side subsidies	No	No	Yes (for public housing only)	No
Construction financing	No	No	Yes (for public housing only)	No
Loan financing	No	No	Yes	No
Orientation program	Yes	Yes	Yes	Yes
Eligible uses of subsidy				
New housing	Yes (anywhere in the country)	Yes (only in selected city or state)	Yes (anywhere in the country)	Yes
Existing housing	Yes (anywhere in the country)	Yes (only in selected city or state)	Yes (anywhere in the country)	Yes
Other			Yes (long-term contract with retirement home)	
Eligible sources of housing				
Private developers	Yes	Yes	Yes	Yes
State-owned housing	Yes	Yes	No	Yes
Current owners	Yes	Yes	Yes	Yes
Non-profit	No	No	No	No

Sources: Struyk (1997), Conway and Mikelsons (1996), Urban Institute (2000), and Romanik and Struyk (1995).

V: Program Design and Implementation

Policymakers routinely introduce variations into the design of housing subsidy programs in response to philosophical, political, and resource constraints. As mentioned earlier, the model subsidy approaches we have discussed up until now can take on substantially different attributes depending on how they are implemented. Considerations about limited institutional capacity or the need to contain administrative costs may prompt policymakers to make compromises in the design and features of a program. In this section, we examine several interrelated design and implementation topics that have a significant impact on the targeting, efficiency, and transparency of programs. We conclude with a brief discussion of ways to control administrative costs.

Participation Rates

To target subsidies effectively, policymakers must successfully enroll the intended beneficiary households in the program. For housing allowance and capital grant programs, participation involves more than simply enrolling in the program. Households must also find housing units that satisfy the program's requirements regarding quality and social norms before they can receive payments. In these programs, the participation rate (in other words, the share of eligible households that actually receive a subsidy) can be mathematically expressed as the product of the percentage of eligible households that enrolls in the program and the percentage of the enrolled households that qualifies to receive payments. It is helpful to think of participation in terms of a two-stage process because it suggests there are two chances for policymakers to manipulate the participation rate.

Policymakers seeking to increase participation can intervene in a number of ways during the enrollment phase. An obvious way to increase enrollment is to increase the benefit level by raising the subsidy or reducing a household's expected contribution. Another approach is to improve outreach efforts by disseminating information through the media, community organizations, or social workers. Part of the outreach efforts may involve reducing the social stigma associated with accepting public assistance. Policymakers can also stimulate enrollment by reducing households' transaction costs. Enrollment remains low when people find it difficult to travel to the locations where they must apply to the program because of time constraints, transportation expenses, or a disability. Having to produce expensive documentation of their eligibility for the program (such as birth certificates or proof of residency) also increases their transaction costs and, thus, restricts enrollment. The need for documentation also introduces the possibility of corruption on the part of those who issue the required paperwork.

Enrolling in a housing allowance or capital grant program does not ensure that an eligible household will receive a subsidy. This is because these programs typically require households to find a housing unit that meets minimum quality standards or social norms. For example, a household may have to move from its existing house to receive a housing allowance because, by the program's specifications, the existing unit is physically substandard or too small for the size of the family. If the burden of moving is too great relative to the benefits that they would receive from the program, then the household is likely to forego the subsidy and stay put.

Improving the quality of housing and utility services for the poor may be a goal of the program, but policymakers must be aware that setting quality standards will increase the administrative costs and institutional capacity required for the program. Usually when minimum quality standards are part of a program's design, professional inspectors must be employed to verify that the beneficiary's unit meets these minimum standards. In Russia's housing allowance program, families are not required to prove that their houses meet particular quality standards; rather, they apply based on their existing housing. The most pressing need for poor Russian families is to cover their current housing expenses, not to improve their housing situation. However, in a country such as South Africa where the poor historically have lived in substandard housing, the inclusion of quality standards may be a politically important aspect of the program.

In a tight housing market, it can be extremely difficult for households to find affordable housing that meets a program's requirements even with their subsidies. By lowering quality standards or norms, policymakers can make more housing available to participants, but this can be controversial. Neither the sponsors nor the beneficiaries of allowance and capital grant programs may like the idea of the beneficiaries having to accept housing of lower quality than that enjoyed by the beneficiaries of other programs. Housing allowance and capital grant programs usually set a time limit on how long a household can take to search for a unit or to negotiate and complete a deal with a builder. After this time limit expires, the allowance or grant is then given to another household. Sometimes a deal with a landlord or developer falls apart but not because of the actions of the household. In these instances, households are usually given a second chance to qualify for their allowances or capital grants.

Governments usually help people to find acceptable units, sometimes by working with private sector developers and brokers to assist prospective buyers or tenants. Also, governments can instigate media campaigns to attract landlords and builders and establish information centers where individuals, landlords, brokers, and developers can post listings. In situations where households are reluctant to use the services of brokers because they regard them as an unnecessary expense, the government must provide consumer education. In tight housing markets, this marketing assistance is critical to the success of a program.

Housing programs can be fairly complicated. In most cases, participants and potential suppliers may need to be informed about how the program works and about any program-related obligations they may face. In countries where the population is not used to market-based transactions, beneficiaries may have difficulty negotiating deals with the private sector suppliers and may need additional counseling. In the case of home purchases using a capital grant, for example, an illiterate elderly beneficiary may require a high degree of "hand-holding" to negotiate legal and financial documents.

Turnover and Recertification

In designing or evaluating a housing subsidy program, policymakers cannot ignore the effect that turnover among beneficiaries has on the program's costs and outcomes. The only information available in many cases is a snapshot of how many households are participating in a program at a given moment. This snapshot, however, does not reveal how many households have participated or will participate over time. High turnover can increase the total number of beneficiaries to the point where it has a major impact on administrative costs, particularly the costs of outreach efforts and of certifying eligibility.

Turnover in housing programs is influenced by external factors that are particular to a country, such as household mobility and the rate at which households move in and out of poverty over time. From the point of view of program design, such factors determine the frequency with which a program requires a household to reestablish its eligibility to receive assistance. There is a tradeoff between the costs of recertifying households and the savings generated by eliminating those who are no longer eligible for receiving benefits. There are administration costs incurred by the program as well as the time and other costs incurred by the beneficiaries who must provide new documentation. While fairly frequent recertification would seem to be an obvious way to improve targeting, the costs of this are often prohibitive.

Means Testing

Housing allowances and capital grants can use means testing to determine eligibility, benefit levels, or both. Conducting means tests can improve the targeting of benefits substantially but can be difficult to implement administratively. Reliable income data are in short supply in many countries, especially when the poor obtain a large share of their income from informal sources. If means testing is used, the government must ensure that the poor can participate in the program despite the difficulty of verifying their income from these sources.

Because reliable income and asset data are often nonexistent, some countries rely on proxy measures of income to determine eligibility and benefit levels. An income proxy is a non-monetary indicator that is assumed to be highly correlated with income. For example, the acreage of farmland owned by a household, the ownership of a car, or the volume of electricity consumed by a household all might be used to estimate a household's wealth. However, even the best proxy systems can suffer from substantial exclusion and inclusion errors.[8] To minimize exclusion errors, the governments who use proxy systems usually establish some sort of procedure for protesting decisions about eligibility. Some governments reserve discretionary funds to help those whom the system may fail.[9]

Some countries may simply decide to rely on self-reported estimates of income combined with a system that attempts to verify as much information as possible within reason. This approach can be enhanced by imposing harsh legal penalties for lying and putting strong social pressure on applicants by educating the public about the program's eligibility requirements. In some programs, the names of beneficiaries are publicly posted, which results in a certain degree of public policing. When a government wants to use means testing, it has to weigh the tradeoffs between potential abuses by households in a self-reporting system and the limitations of a proxy income system.

Despite these problems, means testing is the surest way to target subsidies to the poor. It is not surprising to find non-poor households benefiting from housing programs when eligibility is not tied to income. For example, programs that offer assistance to pensioners, veterans, civil servants, disaster victims, widows, or orphans cannot guarantee that benefits will go largely to poor households. In the case of housing, waiting lists may have been compiled with little regard to income, instead relying on criteria such as social norms for living space.[10] Waiting lists often suffer from transparency problems where it is not clear how a household moves up the list or why other households continue to be far down the queue. In designing new programs, it may be desirable to circumvent existing lists in favor of other eligibility criteria.

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[8] Some countries with proxy systems, such as Armenia, have a strong bias against inclusion errors. From a political perspective, failing to assist a truly needy household (in other words, an exclusion error) may be preferable to mistakenly allowing an undeserving household to benefit (in other words, an inclusion error), especially when there is a high level of government distrust.

[9] Care must be taken to not give too much discretionary power to government bodies or the program may not be sufficiently transparent.

[10] A social norm for living space is typically expressed in terms of square meters per person. A household occupying a housing unit with insufficient living space would be regarded as overcrowded.

Monitoring

By monitoring key aspects of a program's performance, a government can gather the information that it needs to modify or fine-tune the program. The cost of this monitoring should be built into the project from the start. The government should define performance indicators in advance so arrangements can be made to collect the necessary data, including indicators on the beneficiaries as well as on the implementation and administration of the program. Information on beneficiary characteristics, subsidy costs, administrative costs, and other aspects of the program can be used to demonstrate the benefits, transparency, and cost-effectiveness of the program.

Controlling Administrative Costs.

A recurring theme in this section is that the outcomes of the program depend a great deal on the institutional capacity of the government body responsible for its implementation. Building institutional capacity increases the administrative cost of programs. Outreach efforts, recertification, means testing, and monitoring all require substantial staff and resources. Funding is required for personnel, training, transportation, record-keeping systems, office space, and equipment.

There are a number of ways to hold down administrative costs. In some instances, it may be possible to piggyback part of a housing program onto another government program. For example, a new program could take advantage of a means-testing system that is already in place for a general cash assistance program. A network of health social workers might be enlisted to disseminate information about a housing program. Governments can also enlist the aid of non-governmental organizations (NGOs) to educate consumers and perform outreach activities.

VI: Determining an Appropriate Approach

Finally, we describe the situations for which each of the various subsidy approaches is likely to be most effective. Table 3 summarizes the key advantages and disadvantages of the programs described in this report with respect to targeting, transparency, price distortion, institutional capacity, administrative costs, and funding. The table helps to highlight some of the tradeoffs that policymakers must make in selecting a particular approach.

If economists and policymakers were to have their choice of an ideal approach to subsidizing housing expenditures, they would probably avoid programs earmarked for housing altogether in favor of a general means-tested cash benefit in which the subsidy is partly based on housing consumption norms. However, as noted at the outset, the desire by society or government to encourage consumption of these goods and the potentially high expense of these programs often makes this option impractical. Nevertheless, a government that already has a cash benefit program may want to consider the possibility of using it to deliver housing-related subsidies, especially if the subsidies are not large.

A capital grant is a flexible transparent subsidy that does not distort prices. Capital grants can be used for any kind of housing-related expenditure, but they are often used to support homeownership in some manner. The main drawback of this approach is that it is often administratively complex and requires a considerable amount of institutional capacity (although less than an allowance program). The administrative burden is partly a function of the size of the grant. Programs featuring larger subsidies typically require more sophisticated systems for enrollment, verifying eligibility, and monitoring. The one-time nature of the grant frees a government or donor from having to make a long-term commitment to the program, although grant programs can be operated on a sustained basis.

Table 3: Summary of Key Program Attributes

	Program Type		
Program attribute	*Capital grant*	*Allowance (norm-based)*	*Allowance (burden limit)*
Targeting	Good targeting potential depends on outreach, benefit levels, and other factors affecting enrollment and participation; coverage limited by budget constraints.	Same.	Same.
Transparency	High level of transparency; easy to identify costs and beneficiaries.	Same.	Same.
Price Distortion	No price distortion if household faces market prices for units or services provided by the private sector.	Little price distortion if household faces market prices for units or services provided by the private sector, and payment standard is correctly set.	Can strongly distort prices because the household contribution toward expenditures is fixed.
Institutional Capacity	Places fairly high demand on staff and other resources; requires skills and capabilities that may not presently exist.	Same.	Same.
Administrative Costs	Similar to allowances, but somewhat simpler due to one-time nature of subsidy.	Can be relatively high per beneficiary due to outreach, processing, and hand-holding requirements; ongoing nature requires institutional strengthening.	Same as norm-based allowance.
Funding	Does not require ongoing funding; subsidy costs can vary depending on the size of grants, which can range from the cost of a minor upgrade to the price of a new unit.	Requires ongoing funding; may have to appropriate through budget request; subsidy amounts depend on which housing-related services the program covers.	Same as norm-based allowance.

Source: Authors and World Bank (1993)

Capital grants have proven to be particularly useful in the aftermath of natural disasters, in supporting relocation efforts, and in complementing housing finance programs. Despite having a certain degree of administrative complexity, it is possible to put a grant program into operation fairly quickly. Because they can be used to purchase or rehabilitate existing units or to build new units, capital grants can be effective in both tight and loose housing markets. A capital grant program works best where there is a well-developed private sector that can readily supply and rehabilitate units. If a country has a housing finance system, a capital grant program can make market-rate loans affordable to households (by lowering the principal on loans). By requiring households to make contributions, the subsidy level of the capital grant can be reduced.

A housing allowance program is most likely to be acceptable in a relatively well-off country with a solid institutional capacity, secure tenure, and a relatively sound, high- quality housing stock. An allowance program is unlikely to be appropriate in a very poor country where the government may have trouble sustaining recurring subsidy payments and where there is not much support for providing cash assistance to renters or owners who remain in the substandard or informal housing that may make up a large share of the total housing stock. Also, housing allowances probably will not work well in tight housing markets in which the supply of affordable units is limited as they are not as effective as capital grants in directly encouraging new construction. Given these attributes, it is not surprising that, in the past decade, housing allowances have primarily been used in transition countries. In these countries, allowances form a part of the social safety net and are often intended to help protect households from reform-related increases in the prices of maintenance fees, utilities, and rent.

All else being equal, a norm-based allowance is preferable to a burden-limit allowance because of the price distortions introduced under the burden-limit approach. The approaches are otherwise similar in that they are both transparent and have good targeting potential.[11] The expense of these programs, however, may make it necessary for the government to ration the subsidies, thus limiting the coverage of the poor. Also, many poor people may be discouraged from participating by low benefit levels, burdensome enrollment procedures, and other program requirements. The ongoing nature of allowances makes them more administratively complex than capital grants, and, in some countries with a lack of institutional capacity, this may deter some policymakers from adopting this approach. The on-budget nature of allowances may be politically difficult to accept, but the cost may be more palatable if the government can show that replacing inefficient traditional supply-side programs with allowances will generate savings.

The high cost of many capital grant and housing allowance programs means they are not always useful ways to expand housing assistance to cover poor households, especially in low-income countries. Upgrading existing housing and infrastructure is usually the most cost-effective way to improve the living conditions of large numbers of geographically concentrated poor households, particularly in situations where many of the poor occupy informal housing with insecure tenure. Some types of upgrading or renovation by individual households can be financed by small capital grants. However, upgrading many basic services (such as water supply, sanitation, and drainage) requires the cooperation of entire communities.

Perhaps one of the best uses of capital grants and allowances is to help to phase out traditional supply-side programs. Capital grants and allowances can help a government to reduce its involvement in the direct production of housing and to encourage the development of the private sector. In replacing a direct construction program with a capital grant or allowance program, the government does not have to procure new funding. It can simply use the money it has already committed to the sector in a more efficient manner.

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[11] Targeting is usually less effective under the burden-limit approach, depending on the size of the subsidy and the responses of households to the price distortions introduced by this approach.

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Summary Findings

This paper examines the strengths and weaknesses of demand-side subsidy approaches for improving poor households' access to housing services. It begins with a discussion of the rationale for stand-alone housing assistance programs and a description of the ongoing transition away from traditional supply-side housing assistance to demand-side subsidies. The paper presents model demand-side approaches, but also draws on real world examples to highlight various aspects of program design related to targeting, transparency, price distortion, institutional capacity, administrative complexity, and funding. It also describes how variations in the design of housing-related subsidy programs can appear in response to philosophical, political, and resource considerations. The paper concludes with a discussion of the appropriateness of different subsidy approaches for various situations.

HUMAN DEVELOPMENT NETWORK

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The World Bank Social Safety Nets Primer is intended to provide a practical resource for those engaged in the design and implementation of safety net programs around the world. Readers will find information on good practices for a variety of types of interventions, country contexts, themes and target groups, as well as current thinking of specialists and practitioners on the role of social safety nets in the broader development agenda. Primer papers are designed to reflect a high standard of quality as well as a degree of consensus among the World Bank safety nets team and general practitioners on good practice and policy. Primer topics are initially reviewed by a steering committee composed of both World Bank and outside specialists, and draft papers are subject to peer review for quality control. Yet the format of the series is flexible enough to reflect important developments in the field in a timely fashion.

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